MOTION FILED
JUL 15 1994

No. 93-1993

(4)

In The

Supreme Court of the United States

October Term, 1994

IN RE WELLS FARGO SECURITIES LITIGATION

WELLS FARGO & CO., *et al.*,

Petitioners,

v.

HOWARD GREENWALD, *et al.*,

Respondents.

On Petition For Writ of Certiorari
To The United States Court of Appeals
For The Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF
and
BRIEF AMICI CURIAE OF THE AMERICAN ELECTRONICS ASSOCIATION
and
THE ASSOCIATION OF PUBLICLY TRADED COMPANIES IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI

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26 pp

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MOTION FOR LEAVE TO FILE BRIEF AMICI CURIAE

Pursuant to Rule 37.2, the American Electronics Association ("AEA") and the Association of Publicly Traded Companies ("APTC") move the Court for leave to file the attached brief, as *amici curiae*, in support of the petition of Wells Fargo & Co. and others for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit. Counsel for petitioners has consented to the filing of the brief. Counsel for respondents has refused to give consent.

The AEA represents some 3,000 companies in 44 states, spanning the breadth of the electronics industry, including the semiconductor, software, computer, telecommunications, networks and systems fields.

APTC consists of over 500 corporations. APTC's membership includes the newest and smallest publicly traded companies, as well as larger, more mature corporations. Since its founding in the 1970's, APTC has represented thousands of companies before the federal government and regulatory agencies. As the name implies, APTC represents companies in every industry and concentrates on issues of concern common to every public company, rather than those which affect a certain region, economic sector, or industry. APTC strives to: (1) enhance fair and efficient access to the capital markets; (2) increase the opportunity to maximize investment return to long-term investors; and (3) preserve the ability to manage corporate affairs responsibly, free from unnecessary governmental regulation and frivolous litigation.

The members of the AEA and the APTC, like other similarly situated corporations, face the prospect of securities class action litigation virtually any time there is a significant decline in the price of their stock. *Amici* submit that the decision of the court of appeals in this case will exacerbate the trend by preventing district courts from subjecting allegations of securities fraud to meaningful scrutiny. Many members of the AEA and the APTC are located within the jurisdiction of the Ninth Circuit and thus stand to be particularly affected by the decision below.

Although this motion is "not favored" under Rule 37.2, it is presented in the belief that the brief *amici curiae* may assist the Court in its Rule 10 consideration of whether *certiorari* should be granted.

1. Since the petition was filed, the Second Circuit has expressly declined to follow the decision of the Ninth Circuit in this case, announcing that "the dissent by Judge Trott in *Wells Fargo* [is] more consonant with case law in this Circuit." *Shields v. Citytrust Bancorp. Inc.*, ___ F.3d ___, 1994 U.S.App. LEXIS 13465 (2d Cir. June 2, 1994). Thus, one office of the *amici curiae* brief is to discuss *Shields* and the widened, patent circuit conflict that has developed since the petition was filed.

2. The Ninth Circuit's decision minimizes the requirements for pleading a securities fraud case. This minimalist view of pleading strictures is antithetical to Rule 9(b) of the Federal Rules of Civil Procedure and to well-informed viewpoints expressed in Congress and by those Executive Branch officers charged with responsibility for the development and enforcement of the nation's securities laws. The Ninth Circuit has made it easier to charge securities fraud at a time when informed sentiment favors greater protection to defendants by discouraging unjustified charges of fraud and dampening the increasingly automatic filing of securities fraud litigation whenever stock prices decline. Thus, another office of the *amici curiae* brief is to show that the Ninth Circuit's liberal hospitality toward general allegations of fraud is at cross-purposes with other developments in the nation's securities laws.

CONCLUSION

This motion should be granted.

Dated: July 14, 1994

Respectfully submitted,

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BRIEF AMICI CURIAE OF THE AMERICAN ELECTRONICS ASSOCIATION and THE ASSOCIATION OF PUBLICLY TRADED COMPANIES

This brief *amici curiae*, accompanied by motion for leave to file under Rule 37.2, is presented by the American Electronics Association ("AEA") and the Association of Publicly Traded Companies ("APTC") in support of the petition of Wells Fargo & Co. and others for a writ of *certiorari* to review the decision of the United States Court of Appeals for the Ninth Circuit in this cause, reported below at 12 F.3d 922.

DESCRIPTION AND INTEREST OF AMICI CURIAE

The AEA represents some 3,000 companies in 44 states, spanning the breadth of the electronics industry, including the semiconductor, software, computer, telecommunications, networks and systems fields.

APTC's membership includes more than 500 corporations, ranging from the newest and smallest publicly traded companies, to more mature corporations of medium size, to some corporations of Fortune 500 dimension. Since it was founded in the 1970's, APTC has represented the interests of its members before branches of the federal government. As the name implies, APTC represents companies in every industry and concentrates on issues of concern common to every public company, rather than those which affect a certain region, economic sector, or industry. APTC strives to: (1) enhance fair and efficient access to the capital markets; (2) increase the opportunity to maximize investment return to long-term investors; and (3) preserve the ability to manage corporate affairs responsibly, free from unnecessary governmental regulation and frivolous litigation.

The members of the AEA and the APTC, like other similarly situated corporations, face greater prospects of securities class action litigation if the Ninth Circuit decision remains in effect. Indeed, many members of the AEA and the APTC are located within the geographic region covered by the Ninth Circuit.

SUMMARY OF ARGUMENT

The decision of the Ninth Circuit in this case is manifestly in conflict with the decisions of other circuits and the conflict has widened since the petition was filed. The Second Circuit has now expressly declined to follow the Ninth Circuit's decision because it represents a departure from the heightened pleading standard required in securities fraud actions under F.R.Civ.P. Rule 9(b). *Shields v. Citytrust Bancorp, Inc.*, ___ F.3d ___, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994).

The Ninth Circuit's decision diminishes the role of pleading rigor as a tool to curb unmeritorious securities fraud allegations at a time when an informed consensus is moving in favor of greater protection for defendants. Congress and the SEC perceive intolerable costs imposed on publicly-traded companies by excessive numbers of securities fraud cases, blithely filed on a near automatic basis in response to any stock market misfortune. If such suits are not subject to effective, early merit screening, they impose undesirable *in terrorem* effects, including litigation costs and coerced settlement payments. Rigorous pleading requirements for fraud and safe harbor protections for forward looking statements made by securities issuers are devices that impose merit screening. These rules of law balance shareholder rights of redress against the need to deter unmeritorious "strike" litigation. The Ninth Circuit multiplies the costs of unmeritorious litigation and begets more of the same when it relaxes fraud pleading standards and makes forward looking statements broadly actionable.

ARGUMENT

I. *Certiorari* Should Be Granted to Resolve a Conflict Among the Circuits Concerning the Application of F.R.Civ.P. Rule 9(b) to the *Scienter* Requirement for Implied Rights of Action Under Section 10 of the Securities and Exchange Act (15 U.S.C. § 78j(b))

The conflict among circuits ably described by petitioners is now blatant. In *Shields v. Citytrust Bancorp, Inc.*, ___ F.3d ___, 1994 U.S. App. LEXIS 13465 (2d Cir. June 2, 1994), the Second Circuit expressly declined to adopt the reasoning of the Ninth Circuit in *Wells Fargo*, preferring Judge Trott's dissent as a correct statement of the law.

In *Shields*, plaintiff's "pleading technique" was described by the court as "coupl[ing] a factual statement with a conclusory allegation of fraudulent intent." 1994 U.S. App. LEXIS 13465 at *15. The court found that these allegations did not contain facts which "would indicate conscious fraudulent behavior or recklessness," or alternatively would "demonstrate both motive and opportunity to commit fraud." *Id.* at *16. Among other things, the court rejected plaintiff's contention that "motive and opportunity" could be inferred from the allegation that defendants artificially inflated the price of Citytrust stock "to protect their executive positions and the compensation and prestige they enjoy thereby" (*id.* at *18-19). The Second Circuit held that establishing an inference of motive requires a plaintiff to do "more than merely charge that executives aim to prolong the benefits of the position they hold," and explained the consequences of a rule to the contrary:

> If motive could be pleaded by alleging the defendant's desire for continued employment, and opportunity by alleging the defendant's authority to speak for the company, the required showing of motive and opportunity would be no realistic check on aspersions of fraud, and mere misguided optimism would become actionable under the securities laws.

Id. at 20.

The Second Circuit declined to follow what plaintiff characterized as "the less demanding view of the pleading requirements in securities fraud cases" enunciated by the Ninth Circuit in *Wells Fargo*. 1994 U.S. App. LEXIS 13465 at *24-25. After noting that the *Wells Fargo* majority opinion did not address the specificity requirements of Rule 9(b), and that "there is some tension" between *Wells Fargo* and *In re GlenFed, Inc. Securities Litigation*, 12 F.3d 893 (9th Cir. 1993), *reh'g en banc granted*, 1994 U.S. App. LEXIS 3331 (9th Cir. Feb. 25, 1994), the Second Circuit concluded:

> In our view, the opinion in *GlenFed* and the dissent by Judge Trott in *Wells Fargo* are more consonant with case law in this Circuit.

Shields, 1994 U.S. App. LEXIS at *26.

Shields is therefore instructive on three counts: (1) it illustrates the divergent approaches adopted by various courts regarding the requirements for pleading scienter; (2) it confirms that the issues presented by the petition are not merely academic, but rather ones with significant repercussions; and (3) it rejects the proposition that averments about job security similar to those asserted by the

plaintiffs in the *Wells Fargo* case are sufficient to allege scienter.

For the reasons explained by the Second Circuit, the heightened pleading standard of Rule 9(b) serves the vital function of providing a "realistic check on aspersions of fraud. . . . " *Shields*, 1994 U.S. App. LEXIS 13465 at *20. By contrast, allowing plaintiffs to proceed with extraordinarily costly class action litigation without offering anything more than conclusory (and often illogical) averments of "motive" and "opportunity" will increase the flood of lawsuits alleging "fraud by hindsight," and create additional "opportunities for 'undeserved settlements.' " *Id.* at *20-21, citing *In re Time Warner, Inc. Securities Litigation*, 9 F.3d 259, 263-64 (2d Cir. 1993).[1]

II. *Certiorari* Should Be Granted Because the Decision of the Ninth Circuit is at Cross-Purposes with a General Trend Favoring More Protection Against Unmeritorious Securities Fraud Allegations, Not Less

A. There Is a Need for Effective Devices to Curb Unmeritorious Securities Fraud Allegations

Arthur Levitt, Chairman of the SEC, has publicly commented on the problems posed by automatic allegations of securities fraud filed when the price of traded stock falls. "The proponents of litigation reform deserve

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[1] *See also Greenstone v. Cambex Corp.*, 975 F.2d 22, 25 (1st Cir. 1992), in which Chief Judge Breyer noted that allowing plaintiffs to circumvent Rule 9(b) in pleading scienter would sanction "fraud by hindsight."

to be taken seriously, however, because there are indications that our current system is flawed." He further stated that "the Commission also recognizes that the current system imposes substantial costs on issuers."[2]

There is a strong empirical basis for these observations. One study indicates that over the last five years, more securities fraud cases have been brought in California federal courts than any other state in the country.[3] Another study indicates that technology companies are sued far more frequently than any other industry, pay the highest average settlements of any industry – over $9 million – and pay the highest percentages of settlement dollars in relation to investors' market losses.[4] Even so, the average settlement recovery in the cases studied was less than 7% of investor losses.[5] Still another study of several hundred public companies reveals that on average, companies which have been sued for securities fraud spent almost $700,000 on legal fees, and had their premiums almost double for Director & Officer insurance.

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[2] Chairman Arthur Levitt, "Private Litigation Under the Federal Securities Laws," Remarks at the Securities Regulation Institute, University of California, San Diego, Coronado, California (January 26, 1994 at pp. 3-4).

[3] *See* Vincent O'Brien and Richard Hodges, "A Study of Class Action Securities Fraud Cases, 1988-1993," (Law & Economic Consulting Group Inc., 1993), at pp. 1-10 (hereinafter "O'Brien and Hodges").

[4] Frederick Dunbar and Vinita Juneja, "Recent Trends II: What Explains Settlements in Shareholder Class Actions?" (NERA 1993), Tables 5, 6, and 7 (hereinafter "Dunbar and Juneja").

[5] *Id.*, Tables 6 and 7.

The great majority of companies also reported being more reluctant to publicly discuss company performance as a result of being sued.[6]

Chairman Levitt has concluded, "a litigation system imposes tremendous unnecessary costs when it is abused by investors or their attorneys. Our challenge is to find ways to minimize its costs while preserving the rights of defrauded investors."[7]

Others studying the situation have reached the Chairman's view. Senator Domenici concluded after months of investigation that "these frivolous lawsuits are such a menace to publicly traded companies on the NASDAQ that the NASDAQ Self Regulatory Organization decided to recommend reforms to Senator Dodd and me."[8]

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[6] Survey conducted by Venture One for National Venture Capital Association and American Entrepreneurs for Economic Growth, *The Impact of Securities Fraud Suits On Entrepreneurial Companies* (January 1994).

[7] A. Levitt, *Private Litigation*, pp. 1-2.

[8] Statement of Senator Domenici on Introduction of the Private Securities Litigation Reform Act, S. 1976, March 24, 1994. "Proceedings and Debates of the 103rd Congress, Second Session," 140 Cong.Rec., S3685-01, S3706-S3707, 1994 WL 95349 (Cong.Rec.), at 156-64 (March 24, 1994).

Underscoring Senator Domenici's remark, a recent study of 500 companies sued for securities fraud between 1988 and 1993 showed that 38% were NASDAQ traded companies. California was the headquarters for nearly a third of the companies in the study. *See* O'Brien and Hodges.

B. The Current Debate on Securities Reform and "Safe Harbor" Provisions Underscores the Importance of Heightened Scrutiny of Securities Fraud Suits

The need to strike a reasonable accommodation between the legitimate rights of investors to seek redress for fraud and the deterrence of meritless strike suits has been recognized within Congress and the SEC. While Congress considers the possibility of legislative reforms, the SEC is contemplating changes to the "safe harbor" rules governing certain forward-looking statements made by issuers.[9] The Ninth Circuit's decision, which would inhibit meaningful analysis of securities actions at the pleading stage, affects these important issues and therefore merits consideration by this Court.

1. F.R.Civ.P. Rule 9(b) requires specificity in the pleading of fraud allegations. Apart from the court of appeals' decision here, where the whole concept of specificity seems to have been abandoned outright, the debate has been over whether the pleading rigor required under Rule 9(b) should be increased.

On March 24, 1994, in response to the problems noted by Chairman Levitt and others, Senators Dodd and Domenici introduced Senate Bill 1976. The Bill was the product of extensive testimony and fact-gathering in 1993 and

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[9] Petitioners define a "forward-looking statement" as "any statement used by a corporation or its management regarding future developments. For example, disclosures of financial forecasts, predictions or economic trends, and management's plan for future operations are types of forward-looking statements." *See* Pet., p. 5, n.6.

1994 from a wide range of industry experts, academicians, economists, public company executives, and shareholder advocates. The testimony before the Subcommittee on Securities of the Senate Banking Committee focused particular attention on whether existing statutes, rules and regulations, including the Federal Rules of Civil Procedure, provided sufficient safeguards against frivolous securities litigation. Mr. William Lerach, a leading member of the plaintiffs' securities bar,[10] testified that *no* reforms were needed, and that "there are ample legal safeguards in place to protect against unwarranted actions." He expressly cited Rule 9(b) as one of those safeguards: "Federal Rule of Civil Procedure 9(b) requires that securities fraud claims be pleaded with particularity and that each defendant's role in the illegal fraud be set forth in detail."[11] To buttress his argument that Rule 9(b) is working, and that more securities fraud lawsuits are being dismissed on the pleadings, he relied on a 1992 *Wall Street Journal* article describing a purported trend of more frequent dismissals of securities suits. Ironically, one of the principal cases discussed in the *Wall Street Journal* article was the trial court's decision in this case.[12] Later, the *Journal* was reporting an opposite trend,

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[10] Mr. Lerach is one of the counsel for Respondents in this case.

[11] William S. Lerach, Testimony Before the Subcommittee on Securities, Senate Committee on Banking, Housing, and Urban Affairs (June 17, 1993), at p. 5.

[12] Richard B. Schmitt, "More Companies Succeed in Defending Charges That They Defrauded Investors," *Wall St. J.*, April 30, 1992, at B1-2.

namely, that *more* frivolous suits are being brought, particularly against smaller companies.[13]

Consistent with his argument that Rule 9(b) is working, Mr. Lerach urged reform of a different kind, namely, that Congress adopt a "mandatory rule" that plaintiffs in securities class actions can obtain discovery from a defendant corporation whenever a stock price decline is preceded by insider selling.[14] The reason given for this suggested reform is informative. Mr. Lerach argued that this "modified pleading requirement" is required because "in most jurisdictions, a plaintiff cannot survive a motion to dismiss even if he or she shows that such trading took place immediately before such a stock drop."[15]

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[13] B. Bowers and V. Gupta, "Shareholder Suits Beset More Small Companies," *Wall St. J.*, March 9, 1994, at B5.

[14] William S. Lerach, Testimony, June 17, 1993, *supra*, at 26-27.

[15] *Id.* at 26-27. Other advocates who testified or submitted statements to Congress similarly have argued that Rule 9(b) is an adequate safeguard, and that legislative reform is not needed. For example, Professor Joel Seligman of the University of Michigan Law School responded to criticisms about the ineffectiveness of Rule 9(b) by arguing in conclusory fashion that Rule 9(b) was effectively used to dismiss complaints in approximately 60% of some 46 motions studied. Professor Seligman offered no data, however, indicating either that any of the dismissals in question were without leave to amend, or that there was any uniformity, geographic or otherwise, to the cases studied. In the vast majority of cases, particularly in the Ninth Circuit, motions to dismiss are either denied, or, if granted, are granted with leave to amend. According to a 1993 study of some 280 cases over a two year period, only *five* cases in the Ninth Circuit were dismissed without leave to amend. *See* Dunbar and Juneja, *supra*.

Congress has moved to expand Rule 9(b) to require pleading of scienter with particularity. Senators Dodd and Domenici include in Senate Bill 1976 a provision to add a new section to the 1934 Act. New section 39(a) would provide:

> INTENT – In an implied private action arising under this title in which the plaintiff may recover money damages from a defendant only on proof that the defendant acted with some level of intent, the plaintiff's complaint shall allege specific facts demonstrating the state of mind of each defendant at the time the alleged violation occurred.

Although it cannot be predicted whether Congress will enact reform legislation, or what form that legislation will ultimately take, the discussion reveals the idiosyncratic nature of the *Wells Fargo* opinion. The Ninth Circuit has lowered the required pleading specificity just as debate has focused on whether *more* specificity should be mandated.

2. This case demonstrates the fate-tempting hazards facing a company which makes forward-looking statements. If months after they are made, such statements turn out to be inaccurate, the threat of a class action lawsuit looms large, even if the statements were entirely reasonable at the time they were made. As the Second Circuit noted in *Shields*, unless allegations of fraud are subject to meaningful scrutiny, "mere misguided optimism would become actionable under the securities laws." 1994 U.S. App. LEXIS 13465 at *20.

Senate Bill 1976 contains a provision which would direct the SEC to consider the need for rulemaking or

legislation to strengthen the Commission's so-called "safe harbor" rules, and to provide trial courts with appropriate procedural devices for dismissing securities suits based on forward-looking statements otherwise protected by such "safe harbor" rules. Senate Bill 1976, Section 201, reads as follows:

> SEC. 201. SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS.
>
> (a) CONSIDERATION OF REGULATORY OR LEGISLATIVE CHANGES – In consultation with investors and issuers of securities, the Securities and Exchange Commission shall consider adopting or amending its rules and regulations, or making legislative recommendations, concerning-
>
> (1) criteria that the commission finds appropriate for the protection of investors by which forward-looking statements concerning the future economic performance of an issuer of securities registered under section 12 of the Securities Exchange Act of 1934 will be deemed not to be in violation of section 10(b) of that Act; and
>
> (2) procedures by which courts shall timely dismiss claims against such issuers of securities based on such forward-looking statements if such statements are in accordance with any criteria under paragraph (1).
>
> (b) COMMISSION CONSIDERATIONS – In developing rules or legislative recommendations in accordance with subsection (a), the Commission shall consider-
>
> (1) appropriate limits to liability for forward-looking statements;

(2) procedures for making a summary determination of the applicability of any Commission rule for forward-looking statements early in a judicial proceeding to limit protracted litigation and expansive discovery;

(3) incorporating and reflecting the scienter requirements applicable to implied private actions under section 10(b); and

(4) providing clear guidance to issuers of securities and the judiciary.

Fast upon the heels of this proposed legislation, the SEC announced that it would begin actively reviewing its safe harbor rules and considering rule-making to strengthen the existing safe harbors for forward-looking statements.[16] SEC representatives have publicly commented on the need for reform in this area.[17] Similarly, several commentators recently have expressed the view that greater protections should be extended to companies making forward looking statements – even to the point of "implying" a private right of action for such statements, and amending Rule 10b-5 to require a showing of "knowing" securities fraud sufficient to demonstrate "actual

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[16] Christi Harlan, "SEC Seeks to Beef Up Safe Harbor Provisions," *Wall St. J.*, May 17, 1994, at C1, C18.

[17] SEC Commissioner Carter Beese publicly complained that the safe harbor rules are not working, and that procedural rules modeled after the business judgment rule should be promulgated by the SEC in order to encourage more forward-looking disclosures, and to grant public companies "the freedom to be wrong." *See* J. Carter Beese, Jr., "Investor Protection Through Better Disclosure," Keynote Address at the Association of Publicly Traded Companies, 1994 Government Relations Conference, Washington, DC (June 6, 1994), at p. 4.

knowledge that the projection is false" as a precondition to bringing suit.[18]

Once again, the Ninth Circuit's opinion is diametrically positioned. The court of appeals held that dismissal was improper because the complaint adequately alleged misrepresentations in Wells Fargo's Annual Report regarding management's "belief" that loan loss reserves were "adequate." 12 F.3d at 930. Thus, allowing the *Wells Fargo* suit to go forward strikes at the heart of the concerns motivating Congress and the SEC, namely, the ability of plaintiffs to predicate a securities fraud suit based on statements of this kind.

3. It cannot be disputed that there is a strong public policy of deterring litigants from bringing frivolous cases which (a) tie up federal court dockets, (b) force defendants to spend millions of dollars on legal fees (or an equivalent amount to settle the case), (c) result in little or no benefit to investors on whose behalf these cases ostensibly are brought, and (d) cause public companies to provide less forward-looking information to the financial markets. If the court of appeals' decision is an aberration, then the public policy interest has necessarily been pinched by the inappropriately broad allowance of securities fraud damage suits.

Rigorously and uniformly enforced, existing Rule 9(b) represents a powerful deterrent against abusive shareholder class action suits. Indeed, the failure of the

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[18] J. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 Stanford Law Review 961, 1011-1015 (1994).

lower courts consistently to impose stringent pleading standards under Rule 9(b), as exemplified by the court of appeals' decision in this case, has sparked the call for legislative reform. While the proposals embodied in Senate Bill 1976 confirm the seriousness of the problem, it has traditionally been the province of this Court to promulgate and enforce uniform Rules of Civil Procedure. Granting the petition would provide the Court with the opportunity to discharge its oversight function regarding threshold pleading requirements in the federal courts.

CONCLUSION

Filing a class action lawsuit has almost become a Pavlovian response to a declining stock price. The court of appeals' decision inhibits the power of federal courts to curtail this disturbing and undesirable phenomenon. Accordingly, *amici* respectfully ask the Court to grant *certiorari* and reverse the decision of the Ninth Circuit.

Dated: July 14, 1994

Respectfully submitted,

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